


**AR05**

Winspear Business Reference Room  
University of Alberta  
1-18 Business Building  
Edmonton, Alberta T6G 2R6



# **Virginia Energy Corporation**

*1996 Annual Report*



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## **CORPORATE PROFILE**

Virginia Energy Corporation is a junior oil and gas company based in Calgary, Alberta. The Company was formed in April, 1996 as a Junior Capital Pool company under the Alberta Stock Exchange regulations and began trading on May 24, 1996. On August 1, 1996 Virginia Energy acquired a 100% working interest in 640 acres in the Virginia Hills area, a 75% working interest in 160 acres in the Zama Lake area and a 10% working interest in a South Sturgeon Lake property that included 2 producing wells (net 7 bopd to the Company's interest) as our "major transaction".

## **ANNUAL MEETING**

The annual general meeting of shareholders will be held on June 27, 1997 at 2:30 pm in the boardroom at MacKimmie Matthews, Suite 700, 401 - 9<sup>th</sup> Avenue S.W., Calgary, Alberta.

## **MANAGEMENT PHILOSOPHY**

Our philosophy has been to create cash flow through the acquisition and development of high quality oil bearing reservoirs (primarily of Devonian age) in the northern part of Alberta. We intend to achieve a balance between prolific shorter life Zama reefs and the longer term stable production that we expect to obtain in Virginia Hills and Sturgeon Lake. The Company is expecting to add one or two new prospect areas this year.



## REPORT TO SHAREHOLDERS

1996 was the start-up year for Virginia Energy Corporation. Our initial efforts were spent on acquiring property via a major transaction that in the Company's opinion would provide relatively low risk development potential, an opportunity for early cash flow as well as substantial reserves for future development. Once this property was acquired via our "major transaction" the Company then farmed into a 100% working interest in 3 prospects and a 50% interest in a 4th prospect in the Zama Lake area in exchange for a 10% gross overriding royalty on those interests.

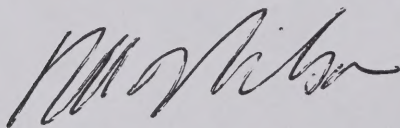
On December 30, 1996 we successfully completed via prospectus dated November 28, 1996 the public placement of common and flow-through common shares grossing \$1,881,294.75. The details concerning this placement can be found in the "Notes to Financial Statements" included in this report. These funds are being used in the Company's 1997 development drilling program.

With the funding in place Virginia began the development of its Zama Lake area properties by acquiring 3-D seismic on several of our prospects. The seismic confirmed the position of the targeted Devonian reef structures previously located by geological mapping.

We planned to begin drilling in January as soon as our funding was in place but because of the extremely high utilization of drilling and workover rigs we were unable to begin drilling the first Zama Lake well (Virgo 9-2) until the end of March and the recompletion of the second well (Amber 8-7) until early April. The high demand for all drilling and associated services has substantially increased the cost of exploiting our prospects. As a result the remaining Zama area wells will be drilled as access and economic conditions permit.

The year ahead will be an extremely significant one for the Company. Our 1997 development program will demonstrate the quality of the properties that we have acquired and our ability to bring them into production. We look forward to exiting 1997 with a significant increase in production.

On behalf of the Board of Directors,

A handwritten signature in dark ink, appearing to read "R.A. Wilson", written in a cursive style.

R.A. Wilson  
President and CEO

## **THE YEAR IN REVIEW**

During 1996 Virginia Energy recorded a negative cash flow of \$25,327 on gross revenues of \$35,808. After G & A costs of \$40,292 and depletion expense of \$3,962 the Company incurred a net loss of \$29,289 for 1996.

## **CAPITAL SPENDING**

Capital spending was made up of the following:

- purchase of oil and gas properties as the Company's major transaction.
- purchase of a 75% share of one 160 acre lease in Zama Lake where the 25% share was acquired via the major transaction.
- acquisition of 320 acres of Crown oil and gas leases in Virginia Hills adjacent to the property we obtained via our major transaction.

## **MAJOR PROJECTS**

### **Virginia Hills**

The purchase of 320 acres of Crown land has increased our land position to 960 acres. We will begin development of this property in late 1997 or 1998. This will likely be done via a horizontal reentry of an existing well to demonstrate the effectiveness of this methodology in exploiting the substantial reserves located in our Virginia Hills properties

### **Sturgeon Lake**

The uncertainty surrounding the validity of our Sturgeon Lake leases is nearing resolution as our operator, Berkley Resources Inc., and the other partners have agreed to withdraw their legal challenge in lieu of a complete divestiture of their interest to one of the defendants, Lyse Petroleum Ltd. However Virginia has opted to retain its interest and has further agreed to participate in two horizontal reentries to reaffirm our 10% working interest in a new "Crown type" 5 year agreement over the entire disputed Sturgeon Lake Indian lease position. Drilling operations are expected to commence in June, 1997. The Company is expecting a substantial level of production to be coming from these properties by year end.



## **Zama Lake**

Virginia Energy began this year's development drilling and recompletion program at the end of March. The first well (Virgo 9-2), in which the Company holds a 75% working interest, was drilled directionally from an existing cased hole into the Devonian reef. The reef was encountered on target which was chosen using geological analysis and 3-D seismic evaluation. This well is still being evaluated. The recompletion of the Amber 8-7 reentry well (75% working interest) is underway and should be completed by the end of May. The remaining Zama area wells will be drilled as access and economic conditions permit. Our technical experts have identified several more Keg River pinnacle reef prospects which will be added to our inventory as the leases become available.

## **PRODUCTION**

The Company has an interest in two producing oil wells at the end of 1996 from which the Company's working interest was 7 bopd at year end.

## **LAND**

At December 31, 1996 the Company had interests in 3903 gross acres (1182 net acres) of mineral leases all of which were in Northern and West Central Alberta. This does not include the gross and net acreage of the disputed Sturgeon Lake Indian Reserve lands discussed under "Sturgeon Lake" above.

## **RESERVES**

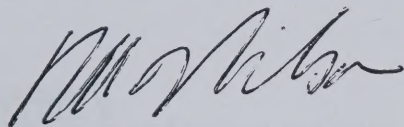
The Company estimated its reserves to be as follows:

	<u>Oil (MSTB)</u>
Proven Producing	20.7
Proven Non-Producing	<u>164.3</u>
Total Proven	185.0
Probable	<u>850.0</u>
Proven Plus Probable	1,035.0
Less 50% Probable	<u>425.0</u>
Proven Plus 50% Probable	610.0

This does not include any reserves associated with the disputed Sturgeon Lake Indian Reserve lands discussed under "Sturgeon Lake" above.

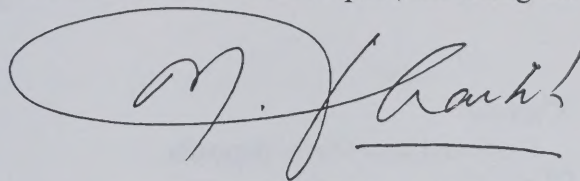
## MANAGEMENT'S REPORT

The annual report and financial statements have been prepared by management and approved by the Board of Directors. The financial statements have been prepared in accordance with generally accepted accounting principles. Management acknowledges responsibility for the fairness, integrity and objectivity of all financial information contained in the annual report, including the financial statements.



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Robert A. Wilson  
President & Chief Executive Officer



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M. H. (Mike) Shaikh  
Secretary & Chief Financial Officer

## AUDITOR'S REPORT

To the Shareholders of Virginia Energy Corporation

I have audited the balance sheet of Virginia Energy Corporation as at December 31, 1996 and the statements of operations and deficit and changes in financial position for the year then ended. These financial statements are the responsibility of the Corporation's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Corporation as at December 31, 1996 and the results of its operations and changes in its financial position for the year then ended in accordance with generally accepted accounting principles.

Calgary, Alberta  
May 14, 1997

"signed" Stan Peloski  
Chartered Accountant



# VIRGINIA ENERGY CORPORATION

## Statement of Changes in Financial Position For the Year Ended December 31, 1996

Operating activities	
Net loss	\$ (29,289)
Add non-cash item:	
Depletion	<u>3,962</u>
Cash flow deficiency from operations	(25,327)
Net change in non-cash working capital	<u>15,194</u> <u>(10,133)</u>
Financing activities	
Issue of common shares	2,731,375
Share issuance costs	<u>(267,680)</u> <u>2,463,695</u>
Investing activity	
Acquisition of petroleum and natural gas properties	<u>(441,911)</u>
Increase in cash, representing cash and short-term deposits, end of year	\$ <u>2,011,651</u>



# **VIRGINIA ENERGY CORPORATION**

## **Notes to Financial Statements For the Year Ended December 31, 1996**

### **1. Incorporation**

The Corporation was incorporated as 679601 Alberta Inc. under the laws of the Province of Alberta on January 2, 1996. On February 15, 1996 the Corporation filed Articles of Amendment and changed its name to Virginia Energy Corporation. The Corporation is engaged in the exploration and development of petroleum and natural gas properties.

The Corporation was classified as a Junior Capital Pool corporation as defined in Alberta Securities Commission Policy 4.11. On July 31, 1996 the Corporation completed its major transaction with the acquisition of petroleum and natural gas properties, as described in Note 3. Accordingly, the Corporation has been transferred to the senior board on the Alberta Stock Exchange.

### **2. Summary of significant accounting policies**

The financial statements of the Corporation have been prepared in accordance with accounting principles generally accepted in Canada. The more significant accounting policies are the following:

#### **a) Petroleum and natural gas properties**

The Corporation follows the full cost method of accounting whereby all costs associated with the exploration for and development of petroleum and natural gas reserves are capitalized into a single Canadian cost centre and charged against earnings as set out below. Such costs include lease acquisition, geological and geophysical, carrying charges of non-producing properties and costs of drilling both productive and non-productive wells and related overhead charges.

Gains or losses are not recognized upon disposition of petroleum and natural gas properties unless crediting the proceeds against accumulated costs would result in a change in the rate of depletion of 20% or more.

Depletion is provided on costs accumulated in a producing cost centre using the unit of production method. For purposes of the depletion calculation, gross proved petroleum and natural gas reserves, as determined by outside consultants, are converted to a common unit of measure on the basis of their approximate energy content.

# **VIRGINIA ENERGY CORPORATION**

## **Notes to Financial Statements** **For the Year Ended December 31, 1996**

### **2. Summary of significant accounting policies (continued)**

#### **a) Petroleum and natural gas properties (continued)**

The Corporation periodically reviews the costs associated with unproved properties and preproduction stage cost centres to determine whether they are likely to be recovered. When costs are not likely to be recovered, an impairment allowance is made.

The net carrying costs of the Corporation's petroleum and natural gas properties in producing the cost centre is limited to an estimated recoverable amount. This amount is the aggregate of future net revenues from proved reserves and the costs of undeveloped properties, net of impairment allowances, less future general and administrative costs, financing costs, future site restoration costs and income taxes. Future net revenues have been calculated using prices in effect at the Corporation's year end without escalation or discounting.

#### **b) Joint venture accounting**

Substantially all of the Corporation's petroleum and natural gas exploration and production activities are conducted jointly with others and, accordingly, the accounts reflect only the Corporation's proportionate interest in such activities.

#### **c) Future removal and site restoration costs**

Estimated future removal and site restoration costs are provided for over the life of the proved reserves on a unit-of-production basis. Costs are estimated by management in consultation with engineers based on current regulations, costs, technology and industry standards. The annual charge is included in depletion expense and actual future removal and site restoration expenditures are charged to the accumulated provision account as incurred.



# VIRGINIA ENERGY CORPORATION

## Notes to Financial Statements For the Year Ended December 31, 1996

d) Flow-through shares

The resource expenditure deductions for income tax purposes related to exploratory and development activities funded by flow-through share arrangements are renounced to investors in accordance with income tax legislation. Petroleum and natural gas properties and equipment and share capital are reduced by the estimated income taxes related to the renounced income tax deductions when the expenditures are incurred.

e) Income taxes

The Corporation follows the tax allocation method of accounting for corporate income taxes. Deferred taxes are provided to the extent that current taxes have been reduced by claiming amounts, primarily exploration and development costs and capital cost allowance, in excess of the related depletion and amortization recorded in the financial statements.

f) Per share data

Net loss per share is calculated based on the weighted average number of common shares outstanding during the year. The weighted average number of common shares outstanding during the year is 5,966,785. Fully diluted net loss per share is not disclosed as the effects of the assumed share purchase options and warrants as disclosed in Note 4 would be anti-dilutive.

3. **Petroleum and natural gas properties**

	<u>Cost</u>	<u>Accumulated Depletion</u>	<u>Net Book Value</u>
Leases and rights	\$ 367,606	\$ 2,971	\$ 364,635
Lease and well equipment	<u>74,305</u>	<u>601</u>	<u>73,704</u>
	\$ <u>441,911</u>	\$ <u>3,572</u>	\$ <u>438,339</u>

# **VIRGINIA ENERGY CORPORATION**

## **Notes to Financial Statements** **For the Year Ended December 31, 1996**

### **3. Petroleum and natural gas properties (continued)**

None of the petroleum and natural gas properties and equipment have been excluded from depletion.

On July 31, 1996, the Corporation acquired certain petroleum and natural gas properties in contemplation of completing its major transaction in accordance with Alberta Securities Commission Policy 4.11. As consideration, the Corporation issued 2,825,000 common shares for \$250,000. For corporate purposes, these properties were valued at \$1,412,500 and therefore, the parties to the transaction determined the value of the common shares exchanged for these properties to be \$1,412,500. For accounting purposes, the acquisition was recorded at \$250,000. The transaction was effected pursuant to subsection 85(1) of the Income Tax Act whereby the Corporation and the vendor elected on an agreed amount of \$149,000. Accordingly, \$101,000 of cost is not subject to deduction for income tax purposes.

### **4. Share capital**

Authorized

Unlimited number of voting common shares

Unlimited number of first preferred shares

Unlimited number of second preferred shares

The first and second preferred shares may be issued in one or more series and the directors are authorized to fix the number of shares in each series and to determine the designation, rights, privileges, restrictions and conditions attached to the shares of each series.



# VIRGINIA ENERGY CORPORATION

## Notes to Financial Statements For the Year Ended December 31, 1996

### 4. **Share capital** (continued)

Issued and outstanding common shares

	<u>Number of Shares</u>	<u>Amount</u>
Issued for cash to Directors and a Trust in which a director is the Trustee	2,000,000	\$ 100,000
Issued for cash	1,000,000	100,000
Issued for cash	3,000,000	300,000
For purchase of petroleum and natural gas properties	2,825,000	250,000
For purchase of petroleum and natural gas properties	166,800	100,080
Issued for cash		
Common shares	797,000	239,100
Flow-through common shares	<u>4,691,985</u>	<u>1,642,195</u>
	14,480,785	2,731,375
Share issuance costs	<u>-</u>	<u>(267,680)</u>
Balance December 31, 1996	<u>14,480,785</u>	<u>\$ 2,463,695</u>

Pursuant to Escrow Agreements, 2,000,000 common shares issued to the founders of the Corporation and 2,118,750 common shares issued in consideration of the purchase of petroleum and natural gas properties are held in escrow by Montreal Trust. The common shares shall be released in equal allotments on each of July 31, 1997, 1998 and 1999.

In connection with the issuance of the flow-through common shares, no qualifying expenditures were incurred in 1996. However, the Corporation has committed to incur \$1,642,195 in qualifying expenditures in 1997.

# **VIRGINIA ENERGY CORPORATION**

## **Notes to Financial Statements** **For the Year Ended December 31, 1996**

### **4. Share capital (continued)**

#### Prospectus offerings

Pursuant to a prospectus dated April 3, 1996, the Corporation issued 3,000,000 common shares at a price of \$0.10 per common share for total consideration of \$300,000.

Pursuant to a prospectus dated November 28, 1996, the Corporation issued 797,000 "A" Units and 4,691,985 "B" Units. Each "A" Unit consisted of one common share and one common share purchase warrant at \$0.30 per unit. Each "B" Unit consisted of one common share on a flow-through basis and one common share purchase warrant at \$0.35 per unit. Total proceeds from the issuance of "A" Units and "B" Units was \$239,100 and \$1,642,195, respectively.

#### Stock Options

The Corporation has established a Stock Option Plan and has granted options to purchase 250,000 common shares at a price of \$0.10 per share to the directors of the Corporation. These options expire April 22, 2001.

Pursuant to an Agency Agreement, the Corporation granted Canaccord Capital Corporation (the Agent) an option to purchase 300,000 common shares at a price of \$0.10 per share. This option expires November 24, 1997.

#### Warrants

Pursuant to a prospectus dated November 28, 1996, the Corporation issued 5,488,985 share purchase warrants to unit subscribers. Two share purchase warrants entitle the holder to acquire one common share at a price of \$0.50 until November 27, 1997.

Pursuant to Agent's Warrants Agreements dated December 20, 1996 and December 30, 1996, the Corporation issued 548,899 share purchase warrants to Canaccord Capital Corporation (the "Agent"). Each share purchase warrant enables the Agent to purchase one common share at a price of \$0.33. 340,050 warrants expire on June 20, 1998 and 203,849 on June 30, 1998.



# VIRGINIA ENERGY CORPORATION

## Notes to Financial Statements For the Year Ended December 31, 1996

### 5. Income taxes

- a) The Corporation has incurred income tax losses which are available to offset income from operations to the extent of \$78,535 until 2002. The value of these loss carry forwards has not been recorded in these financial statements.
- b) The provision for income taxes differs from the result which would be obtained by applying the combined Canadian Federal and Provincial income tax rate of approximately 44.3% to loss before income taxes. The difference results from the following:

Expected recovery	\$ (12,975)
Increase (decrease) in taxes resulting from the following:	
Non-deductible charges	1,836
Other	(23,652)
Losses for which no tax benefit is recorded	<u>34,791</u>
Provision for income taxes	\$ _____

At December 31, 1996, the Corporation had net book value in excess of income tax pools in the amount of \$97,428.

### 6. Related party transactions

During the year ended December 31, 1996, the Corporation paid consulting and professional fees to companies controlled by directors of the Corporation in the amount of \$22,362. The consulting and professional fees have been allocated as follows:

Consulting fees	\$ 10,000
Professional fees	8,147
Petroleum and natural gas properties	4,215

# **VIRGINIA ENERGY CORPORATION**

## **Notes to Financial Statements** **For the Year Ended December 31, 1996**

### **7. Subsequent events**

Subsequent to the year end, options in respect of 50,000 common shares, issued under the Stock Option Plan, were exercised for proceeds of \$5,000 and Agent's options in respect of 100,000 common shares were exercised for proceeds of \$10,000.



## **CORPORATE INFORMATION**

### **Head Office**

**Virginia Energy Corporation  
303, 630 - 6th Avenue S.W.  
Calgary, Alberta T2P 0S8**

**Telephone: (403) 205-3722**

**Fax: (403) 266-1927**

### **Board of Directors**

**Kenneth S.Meek  
David S. Ragan  
M.H. (Mike) Shaikh  
Thomas Simmons  
Robert A. Wilson**

### **Officers**

**Robert A. Wilson  
President & Chief Executive Officer**

**M.H. (Mike) Shaikh  
Secretary & Chief Financial Officer**

**Kenneth S.Meek  
Vice President Exploration**

**David S. Ragan  
Vice President Operations**

### **Auditors**

**Stan Peloski  
Chartered Accountant  
Calgary, Alberta**

### **Solicitors**

**MacKimmie Matthews  
Barristers & Solicitors  
Calgary, Alberta**

### **Bankers**

**Royal Bank of Canada  
Calgary, Alberta**

### **Stock Exchange Listing**

**Symbol: "VRG"**

### **Abbreviations**

**BBLS - barrels  
MBBL - thousand barrels  
BOPD - barrels of oil per day**

**Virginia Energy Corporation**  
303, 630 - 6th Avenue S.W. Calgary, Alaberta, T2P 0S8  
(403) 205-3722 Fax (403) 266-1927